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Economic and Technical Factors Behind the Rise and Fall of Economic Globalization and Some Consequences in Hungary

A Historical Perspective

Summary
Although globalization has been going on for quite a time, after 1970 it took new forms. Foreign direct investments were made in increasing amounts just to optimize the value chains of large transnational companies. The activities requiring unskilled workers were outsourced to underdeveloped peripheral countries like China, Vietnam and Malaysia in Asia, and after 1990, to Romania, Slovakia or Hungary in Central and Eastern Europe. At the same time the activities that require skilled and high-quality labour were kept in Western Europe. TNCs made profits on the difference between the low wages paid in peripheral countries and high prices charged in developed ones. Although it seemed that globalization cannot be stopped, a new development, robotisation might slow down or even completely stop this process: why should a company outsource any activity to a faraway developing country and transport goods for thousands of miles if they can use relatively cheaper robots at home, close to the key markets? Robots may be considerably cheaper and more disciplined than any human worker in a cheap-labour country. Robotisation has significant economic and social consequences, as the budget revenues of governments might decline, as a large
part of government revenues comes from taxes levied on wages. With significantly less workers the budget revenue is reduced. In Hungary the results of heavy taxes on labour (to a minor extent, personal income taxes and more importantly, social security contributions) are felt, as the discrepancy between net and gross wages is too high, and thus when the EU labour market opened up to Hungarian workers, nearly half a million Hungarians (around 10% of the active population) left the country for Western Europe.

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**Definition and the various aspects of globalization**

In 2000, the International Monetary Fund (IMF) identified four basic aspects of globalization:

- international trade and transactions,
- international movement of capital and investment,
- migration (movement of people), and
- international dissemination of knowledge (IMF, 2000).

We might suppose that, after the emergence of the technological, legal and cultural preconditions, economic globalization moves first and is followed by other aspects of globalizations, but it is not always true: political problems might slow down or even completely stop economic globalization. Political conditions can also be regarded as the precondition to and result of economic globalization.

*How to measure the level of economic globalization?*

Economic globalization is generally regarded as the rapid growth of

- foreign trade,
- foreign investments,
- international mobility of labour force.

The periods when these factors develop more rapidly than GDP can be regarded as the Tides of Globalization, and when they develop less rapidly that GDP, as the Ebbs of Globalization (Katona, Árva and Schlett, 2013).

There are different ways of measuring the ebbs and tides of globalization. There are more precise and complicated, and there are simpler but more easily measurable methods. One of the most elegant measurements of globalization was worked out by the Centre for the Study of Globalization at the Warwick University (Warwick, 2017). This elaborate system measures the economic, political and cultural aspects of glo-
balization and creates a synthetic index (called “CSGR index”) by assigning various weights to the different measurements. This index is rather complicated and has an elegant mathematical background. The value of CSGR is normalized between 0 and 1, and the higher values are assigned to the higher level of globalization. Unfortunately, the CSGR value has been computed only for a rather short period between 1982 and 2004, due to a lack of available and reliable data.

So, although we have a good and elegant globalization index, it is often useless for historical analyses as does not cover a sufficiently long period. Unfortunately, the CSGR index only includes relatively short and highly unreliable time series. More importantly, the most recent CSGR index relates to 2004, and so it is rather old. For this reason, it is more advisable to look at less sophisticated, although perhaps less perfect, indices, like the Long-Term Globalization Index of Angus Maddison, which compares the growth of international trade to GDP growth rate. A few years are also missing from these data, although Maddison made tremendous efforts at collecting long-term economic data from different countries.

When GDP grows more rapidly, than international trade, economic growth is faster than trade growth, this is an ebb in globalization, and a period when trade develops more rapidly can be regarded as a tide in globalization. The figures collected and computed by Angus Maddison (2007) suggest about 3 tides and 2 ebbs in globalization throughout economic history.

Table 1: Stages of globalization

<table>
<thead>
<tr>
<th>Period</th>
<th>Average annual growth in world trade</th>
<th>Average annual GDP growth</th>
<th>Annual average GDP growth to average trade growth</th>
</tr>
</thead>
<tbody>
<tr>
<td>1500–1820</td>
<td>0.98</td>
<td>0.32</td>
<td>3.0 1st TIDE (the EBB was perhaps between 1750 and 1820, but data are insufficient)</td>
</tr>
<tr>
<td>1820–1870</td>
<td>4.18</td>
<td>0.94</td>
<td>4.4 2nd TIDE</td>
</tr>
<tr>
<td>1870–1813</td>
<td>3.40</td>
<td>2.12</td>
<td>1.6 2nd TIDE (slower)</td>
</tr>
<tr>
<td>1913–1950</td>
<td>0.90</td>
<td>1.82</td>
<td>0.5 2nd EBB</td>
</tr>
<tr>
<td>1950–1973</td>
<td>7.88</td>
<td>4.90</td>
<td>1.6 A small TIDE</td>
</tr>
<tr>
<td>1973–2003</td>
<td>5.38</td>
<td>3.17</td>
<td>1.7 3rd TIDE</td>
</tr>
<tr>
<td>1820–2003</td>
<td>3.97</td>
<td>2.25</td>
<td>1.8 TIDEs and EBBs together</td>
</tr>
</tbody>
</table>

Source: Maddison, 2007, p. 81, with the author’s remarks
Stages of globalization

According to various globalization theories, globalization takes place in consecutive stages. By the most widespread theories (Benichi, 2007, or Katona, Árva and Schlett, 2013), economic globalization started in the 16th century with the great geographical discoveries, continued during the “long 19th century”, approximately between 1789 and World War I, and currently we are undergoing the third wave (Berger, 2003). In the 15th and 16th centuries, mainly rare and precious raw materials have attracted foreign trade and foreign investments and drove infrastructure development abroad (harbours, roads, etc.). It is interesting that the intensive tides in globalization slowly faded away in the 18th century, mainly because of the long and merciless wars that tore Europe: the Eighty Years’ War, the Nine Years’ War, the Seven Years’ War, the Napoleonic Wars, and many others.

In the 19th century the picture changed drastically. According to Berger’s research, the 19th century can be regarded as the forerunner of the current economic globalization, with foreign investments and even some transnational companies. Market buying investments appeared and a few transnational companies were launched before the end of “the long 19th century”, as the devastating and long 1914 war stopped globalization abruptly (Berger, 2003).

Note that even a few years before the “Great War” that started in 1914, several economists considered it highly improbable to have armed conflicts in Europe. As Norman Angell, the famous columnist of The Economist wrote in an article, and later in his popular book entitled The Great Illusion (Angell, 1911) that “war is economically and socially irrational and wars between industrial countries are useless because conquest did not pay”. He also added that even if there would be a war in Europe, it would be short. He argued that the “economic interdependence” of nations (in other words, globalization) is the “guarantee of lasting peace”.

All we know is that this bright future has never arrived, and in 1914 not only a bloody and disastrous war started, but the glorious years of 19th-century globalization had quickly came to a long-lasting standstill.

The Great War ended in 1918, but the political and economic conditions were still unripe for a return to original level of globalization. On the one hand, small nation states were created in Europe to replace former large Germany, the Austro-Hungarian Monarchy and of the Ottoman (Turkish) empire. Russia was transformed by the Bolshevist revolution to a country moving towards economic isolation and autarchy. In addition to all these political stresses, in 1929 a great economic crisis swept over the world. With the beginning of World War II in 1939, all hopes of returning to pre-war globalization were lost.

Globalization after World War II

After World War II, the world was divided into three distinct groups of countries, each following a different way of development.
1) Developed market economies wanted to re-establish free trade and free capital movement, i.e. the traditional globalization.

2) The Soviet Union and the socialist bloc surrounding it became increasingly isolated and formed an autarchic group of countries rejecting globalization.

3) The newly independent colonies, called “developing countries”, were in between the two larger groups and have called themselves “Third World, or Non-Aligned Countries”, and this country group was not very enthusiastic on globalization either.

**Western Europe and the globalization after 1945**

After World War II, due to the losses suffered during the World Wars, there was a serious shortage in labour force in Western Europe. As a high number of men died during the wars, the manufacturing industry, which was rapidly growing after the war, was seriously short of labour.

The solution for that problem was admitting people to Western Europe from the colonies (or after 1960, rather from the former colonies) and employ them in the newly built and rapidly developing factories.

Millions of people arrived in Western Europe from Africa and Asia and were employed in the automotive industry, in manufacturing household appliances, etc. This policy worked till the end of the 20th century, when new economic, cultural and political developments started to cause serious problems in these countries. They included demands for equal pays to the recently arrived workers to those indigenous in Europe, and protests against the rejection and seclusion of immigrants, or the descendants of immigrants, by the native majority, which (not surprisingly) caused negative sentiments. Slowly but steadily, these increased tensions.

The developed countries made enormous efforts at re-launching globalization, and so this period saw the creation of the most important international economic organisations, as the World Bank Group, the IMF, the GATT, the UNCTAD, and others. This was also the time of establishing the European Economic Union, the predecessor of the European Union.

**Socialist countries outside globalization**

The socialist countries were nearly completely excluded from the globalization process as they blatantly refused it. In addition to distancing themselves, these countries openly rejected all forms of the market economy, especially international capitalism. Globalization was the worst idea for the politicians of the socialist countries. They wanted to develop on their own, from their own resources, and the use of foreign credit was rejected for a long time.

**Globalization and the so-called “developing countries”**

The underdeveloped former colonial countries (politely termed “developing countries” after independence had been won) also tended to reject globalization as they...
suspected the manipulations of their former colonialists in this idea. They nationalized foreign-owned assets in agriculture, industry and trade, and decided to set out on their own economic development, without strong ties with the former colonizers.

These countries followed the “developmental state strategy”, elaborated in Latin America by Celso Furtado and Raúl Prebisch, the most important economists of the third-world countries, which relies on the “centre-periphery” theory and advocates “protectionist and state assisted” industrialization.

The starting point of the idea is highly rational: in the 19th century Latin America had a traditionally important trade with Western Europe. Latin American countries exported raw materials (mainly food) to Europe and they bought manufactured goods from Europe. But after 1914 this model suddenly collapsed with the war. Trade was blocked during the war by German submarines and after the war by the ensuing economic difficulties, including the Economic Crisis of 1929-1933. After 1939, World War II repeatedly halted trade between Latin America and Western Europe. As all these difficulties nearly completely destroyed trade with Europe, Raoul Prebisch maintained (Prebisch, 1950) that it was important for Latin America to start industrialization on its own. He argued that industrialization should be promoted by the state. Similar models were applied after 1960 in South-East Asia, Singapore, South Korea, Taiwan, Malaysia, the Philippines, etc. fairly successfully. Frequently, experts from even socialist countries visited third-world countries to help their industrialization efforts.

**Drawbacks of state-organised industrialization**

It was often maintained that state-assisted industrialization might cause corruption and a close cooperation between the political and economic elites, where only those can succeed who enjoy support from the political ruling class. This is often called “crony capitalism”, a term coined in the Philippines during the Marcos regime and credited to business editor George M. Taber of the *Time* magazine, who first used it for the Philippines in an article in the April 21, 1980 issue called “The Age of Crony Capitalism” (Hau, 2017). Taber maintained that state-assisted industrialization is the hotbed of corruption and is consequently biasing the distribution and efficiency of resources. Others argued that the case was just the opposite: without active state participation and help, efficient industrialization is impossible in underdeveloped countries.

Unfortunately, convincing empirical examples or even econometric results are unavailable to support any of these opposing statements, and further research is needed in this field.

**Increasing state deficits due to state-assisted industrialization in the 1970s**

State-assisted industrialization efforts were generally financed from state revenues and credits, a large part borrowed from abroad. By the end of the 1960s the majority of de-
Developing countries had accumulated huge debts to invest in industrial development. In that decade no one was worried about its increase, as it was taken for granted that industrialization would create the capacities required for repayment.

However, during the 1970s, the pointless US spending on the Vietnam War, the powerful wage demands of the British Trade Unions, the oil price hikes after the OPEC crude oil embargo following the 1973 Yom Kippur war, and the declining oil supply due to the war between Iran and Iraq ran the world economy into a formerly unknown phenomenon: stagflation, which is a state of economic stagnation with increasing prices. Latin America was extremely severely hit by the crisis, as these countries had already been heavily indebted: between 1975 and 1982 Latin American debt to commercial banks increased at a cumulative annual rate of 20.4 percent. External debt of Latin America rose from USD 75 billion in 1975 to more than USD 315 billion in 1983, or 50 percent of the region’s gross domestic product (GDP).

The problems of these countries only aggravated when in 1979 the Fed decided to increase the interest rate. In addition to making it more difficult to borrow money, it also rapidly increased debt service. The exchange rates of Latin American currencies started to depreciate, as current account problems deteriorated. As a result of depreciation to the US dollar, Latin American governments ended up owning tremendous quantities of valueless national currencies. The contraction of world trade in 1981 caused the prices of their major export products, the primary resources, to fall. Third-world countries were thrust to the brink of bankruptcy by the middle of the 1980s.

A “solution” for the debt crisis: the Washington Consensus

Among these circumstances, the USA made an “Irresistible Offer” to the Latin American countries: this was the famous Washington Consensus, suggested by the US administration’s Washington think tanks and from the IMF experts, and were edited by John Williamson, an economist from the Institute for International Economics, an international economic organisation, based in Washington D.C. (Williamson, 1989). The most important topics of the Washington Consensus were privatisation, deregulation and the liberalisation of FDIs.

The message, after a brief hesitation, was well received by the heavily indebted developing countries: these economies were opened up to foreign investors and privatisation began. Not surprisingly, in 1990 the former socialist countries were given the same advice, and followed it enthusiastically.

Globalization at the end of the 20th century

Clearly, globalization was largely driven by foreign direct investments and the rising foreign trade. The end of the 20th century saw the peak of the third tide of globalization and foreign direct investment. The major causes of a rise in globalization included the following:
– The legal conditions of FDI become free of constraints in the third world and in
the former socialist countries.
– The freedom of foreign trade had increased.
– Transportation and communication developed rapidly.
– There was a relative political stability during the cold war.

During the 19th and at the beginning of the 20th century foreign direct invest-
ments was primarily made in order to purchase market shares (“market buying invest-
ments”) in rich countries situated close to markets. A minor amount of investments
were made in developing countries to obtain resources and raw materials (crude oil,
coal, and special materials required for metallurgy or for the computer industry)
(“resource buying investments”). Investments in extraction industries were generally
implemented in Africa, in the Middle East or in Latin America, in relatively poor
countries.

But by the end of the 20th century, new tendencies had emerged: as rich countries
paying relatively higher wages were no longer competitive in low added value assem-
bling, these activities were often outsourced from the centre to the peripheries, to
developing countries with low wages. Through outsourcing companies realized com-
petitive advantages. “Offshore outsourcing investments” had become the most impor-
tant form of FDI by the end of the 20th century and contributed considerably to glo-
balization, as modern technology and brand-new products arrived in underdeveloped
countries. Transnational Companies (TNCs) made profits on the differences between
the low wages paid in the countries where production was performed and the high
wages, and consequently higher prices, in their markets in the developed countries.

Naturally, traditional “market buying investments”, which first appeared at the end
of the 19th century, and the “colonial type investments”, made primarily to obtain raw
materials and serve energy generation, have also survived. In addition, another type
called “state subsidy hunting” investments also emerged, as governments, eager to at-
tract as much foreign direct investment as possible, began a “race to the bottom”, i.e.
to provide generous tax cuts and even subsidies to foreign investors.

Hungary in the whirlwind of globalization

After 1990, Hungary was rapidly globalized. Privatisation included the sale of state-
owned enterprises to foreign strategic investors, and in addition, greenfield invest-
ments also entered Hungary. In the CSGS Index of the Warwick University Hungary
rather high. (Figure 1)

Note that in this Complex Globalization Index, Hungary ranked 14th of 135 coun-
tries in 2004. Unfortunately, more recent data are unavailable for the Globalization In-
dex. In view of the developments of the past few years, the overall picture probably has
not changed, although perhaps Hungary’s Globalization index might has diminished.

As the promises of globalization, namely, rapid economic development and uni-
versally improving living standards, have not been fulfilled, a relatively strong anti-glo-
balist sentiment has emerged in Hungary at the beginning of the 21st century. A few
formerly privatised companies have been re-nationalized and the government supports local Hungarian businesses in developing their capacities. This was somewhat similar to the above-mentioned state-assisted industrialization seen in the third-world.

Factors working against globalization at the end of the 20th century

Certain factors worked against globalization towards the end of the 20th century, such as:

1) The copying of high-tech European and US products in China jeopardised the technological monopoly of companies in rich core countries.

2) Inequality increased all over the world (Credit Suisse, 2017) and triggered anti-globalization sentiments.

3) Nationalist sentiments in target countries (in Latin America and some South Asian countries) fuelled anti-globalization movements.

4) The unfulfilled or broken promises of globalization evoked anti-globalist attitudes in the former socialist countries.

5) In capital exporting countries fears also led to protectionism in the interests of the local labour force (note President Trump’s measures).

However, these factors were superseded by economic interests, and offshore outsourcing has continued up to this day, although the 2008 economic crisis slowed it down (UNCTAD, 2017). Yet another factor that has put globalization at risk is technological development.
Is this the end of globalization?

Is technological development, namely robotisation, the ultimate cause of the possible demise of globalization?

Technological development has already started to pave the way to the end of off-shore outsourcing and globalization. Globalization was hard hit by the emergence of robotics, as the use of robots in assembling will render offshore outsourcing pointless: robots are much cheaper and more precise than the cheapest and most precise workers in any developing country. Consequently, in the early 21st century, offshore outsourcing and foreign direct investment has become economically useless and irrational.

Robotisation also has unpleasant consequences. First of all, as lot of experts have pointed out, the use of robots reduces employment. It is a major concern who will buy the newly produced goods if workers’ headcount falls. Another point mentioned by Krugman back in 2012 is that GDP would be distributed even more unequally than now, as the share of labour would decline, and so rich people will get richer, while the poor will sink into deeper poverty. A similar remark was made by labour economist Richard Freeman (2016) in his paper titled “Who Owns the Robots Rules the World”, arguing that most people’s jobs are at the risk of becoming robotized or otherwise automated.

The use of robots will also jeopardise the functioning of social security systems and welfare states in Europe (elsewhere we can hardly find anything similar to welfare state or social security system). Robots do not pay taxes and social security contributions. Currently, social security and welfare expenditures are financed from charges on wages, but if robots make workers redundant, unemployment will also increase in developed countries. Developing countries, the traditional targets of offshore outsourcing, are in a fare more serious trouble. Immigration to rich countries would be accelerated by the increase in unemployment resulting from the drying up of capital flows to developing countries. These problems are further aggravated by climate change in the Middle East and in Africa.

Social and economic conclusions of the new developments of Globalization: melt down of state revenues

As we have seen, Globalization has entered into a new phase after the 1970s as the answer to the new problems was offshore outsourcing. The results of this offshore outsourcing were important for the economy, as

– it has made possible to reduce costs of production,

– products and services were sold in the rich developed countries,

– the profit was realised in the industrialised, rich countries,

– tax revenues of the countries all over the World have diminished radically due to transfer pricing and corporate tax reductions provided or Foreign Direct Investors in order to attract more investments into the poorer countries.
Transfer pricing means that transnational companies are “optimizing” overall corporate taxes by modifying prices of their services and goods circulating between different units of the TNCs. Consequently, tax revenues of the states were melting down. State revenues could only be rebuilt by collecting state revenues through relatively new (“unorthodox”) taxes, like VAT, as it was made in Hungary after 2010.\(^2\)

At the same time technological development seems to destroy the very bases of globalisation. Use of artificial intelligence and the spread of robotization had made offshore outsources rather useless. But the collapse of globalisation might also cause grave problems for the states. One of the major consequences is the possible collapse of the budgetary revenues of the poorer countries, which were relying heavily on taxes charged on wages.

*High wage taxes are already causing grave problems in Europe and especially in Hungary\(^3\)*

Hungary ranks 60th in the World Economic Forum’s 2017-2018 World Competitiveness Report (World Economic Forum, 2017), which identifies five major causes for this disappointing performance:

1. Inadequately educated workforce;
2. Corruption;
3. Tax rates;
4. Tax regulations;
5. Access to financing;
6. Instability in policies.

Not surprisingly, taxation (including rates and regulations) is high on the list. The Hungarian tax wedge are almost the highest in Europe, currently next only to Belgium. “Tax wedge is defined as the ratio between the amount of taxes paid by an average single worker (a single person at 100% of average earnings) without children and the corresponding total labour cost for the employer. The average tax wedge measures the extent to which tax on labour income discourages employment. This indicator is measured in percentage of labour cost” (OECD).

The consequences of a high tax wedge in Hungary are disappointing:

1. Differences between net and gross wages are very high.
2. Nearly half a million Hungarian workers, approximately 10% of the active population,\(^4\) have left the country to work in Western Europe.
3. SMEs are in a competitive disadvantage, as foreign-owned large TNC’s generally sell their products in Western Europe, where purchasing power is considerably higher, and consequently, higher prices can be charged. In Hungary social security contributions do not hinder TNC’s activities.
4. SMEs are often compelled to try to evade taxes, and so they simply do not register their employees or register them at considerably lower wages than actually paid.
5. Employees unregistered for social security are frequently ineligible for healthcare.
6. Workers registered at lower-than-actual wages will not receive proper pension when they retire.
Although in the past few years, the Hungarian government has made efforts to reduce the tax wedge by lowering certain social security charges, the outcome remains unconvincing and rather haphazard. The measures taken so far have not clarified or simplified the taxation regime as a whole.

**Solution for the high tax wedges and for the disappearance of budget revenues from wages taxes: the Scandinavian method of healthcare financing**

As shown above, the traditional financing of social security (when either the employee, or/and the employer pay charges to finance healthcare, pension and the unemployment benefits) causes difficulties by increasing the gap between net and gross salaries, and might incite tax evasion and/or emigration.

Fortunately, for this problem there is a solution that has worked fairly well in the past few decades in some Western European countries. It is called the “Scandinavian method of healthcare financing”.

In the UK and in the Scandinavian countries (Sweden, Finland and Denmark) the healthcare system is financed from the general budget instead of taxes levied on wages. The term generally used for this method is “fiscalisation”, but for political marketing reasons I suggest replacing it with the expression “Scandinavian healthcare financing”.

In this proposal we deliberately were not speaking on the pension system, as it would be extremely difficult and even politically counterproductive to finance pensions from the general budget. People generally would like to keep the “transforma-
“Scandinavia” has a positive, but “fiscalisation” a far less positive connotation in Hungary.
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